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TAGS: EFIN ECON ENRG PGOV FR
SUBJECT: PM DE VILLEPIN'S PLANS FOR SOCIAL ECONOMIC GROWTH

Ref: (A) Paris 5936; (B) PARIS 5694

¶1. SUMMARY. Prime Minister de Villepin unveiled the second phase of his economic plan, the key feature of which is the retention of the French social model. This second set of measures, which adds new budget spending, is unlikely to have real positive effects on economic growth before 2006. Measures in favor of employment miss the supply-side aspects of labor issues. END SUMMARY

PM Supports "Social Economy", but also Competitiveness and Work
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¶2. On September 1, Prime Minister De Villepin announced economic measures (that would have been introduced by Finance Minister Thierry Breton in other circumstances), a week before the expiration of the 100-day deadline that he set upon taking office in June. The second phase of his plan for a "social economy" is supposed to stimulate faster economic growth, while preserving the benefits of the French welfare model. De Villepin said "our social model answers the profound concerns of the French, but, in a fast changing world, we urgently need to modernize it to continue to keep ahead." He insisted that he wanted "to promote growth for everyone, which restores people's purchasing power, which generates jobs. I also want it to be more attractive and easier to work in France than to live on welfare." He said that all his time would be devoted to the French, and stressed: "we are in a difficult time, a difficult situation. All my energy, all that of government, will be dedicated to the interests of our compatriots." He argued that the drop in unemployment in July, to below 10% for the first time in about two years (ref A), "proved that we can win the battle of employment," and that already 30,000 new contracts ("contrats nouvelles embauches" - ref B) were signed in a month. As part of a move to modernize the French model, Prime Minister de Villepin doubled the amount of new spending to 9 billion euros for economic competitiveness, a better recognition of labor, and purchasing power.

Cutting and Reforming Income Taxes in 2007

¶3. The government will resume income tax cuts, which were frozen in 2005, at a cost of around 3.5 billion euros in ¶2007. Tax cuts notably include an increase in rebates to the lowest-income earners, at a cost of 1 billion euros by ¶2007. De Villepin said "the reduction in income tax will resume in 2007 with 2006 revenues (source of information for 2007 income taxes) as part of a tax reform."

¶4. Tax cuts will be combined with a reform of the French income tax system, effective January 1, 2007 to make it more transparent and readable, in a way to help "each French citizen see clearly and immediately which portion of his income is going toward the good functioning of the country." The reform will reduce the number of tax brackets to four from seven with the highest marginal rate reduced to 40% from 48.09%, and is supposed to increase the take-home pay for the middle class. For example, a single person earning 30,000 euros a year will have a 15% tax reduction. Nonetheless, the 20% and 10% deductions that are automatically granted to wage-earners will be replaced by a 10% deduction, and overall deductions per income tax payer will be limited to 8,000 euros in the general case.

¶5. De Villepin did not make direct comments about the wealth tax, but said that its reform was not a priority. He asked Finance Minister Thierry Breton and Budget Minister Jean-Francois Cope to find from which point "the wealth tax loses its legitimacy and its efficiency" and also "to set a new maximum tax reduction" in order to avoid tax flight.

Returning Money to Low-income Individuals

¶6. The government will not cut the speed limit on highways as it had initially proposed to reduce surging costs of rising oil prices. Instead, several million low-income households will receive a 75-euro check to help cope with the surge in heating-oil costs following the rise in oil prices.

Encouraging Work and Mobility

¶7. In a move to make "work more attractive and easier in France than living off public assistance benefits," De Villepin promised extra money to reward unemployed people who find jobs. The GOF will extend the 1,000 euro earned income tax credit (EITC) not only to long-term unemployed who return to work (as proposed in June) but also to all recipients of minimum incomes and allowances. EITC will be paid on a monthly basis in 2006, no longer at the end of a 12 or 18 month-period. All former and new EITC beneficiaries (potentially 8.8 million people) will also receive 150 euros a month during a year, a cost for the government of 500 million euros in 2005, and of 1 billion euros in 2006 to be funded by extra-receipts from the tax on petroleum products.

¶8. Separately, on September 12, Thierry Breton announced two measures to increase the mobility of workers in France (while scolding that 500,000 vacancies are available in construction and restaurant sectors):
- a 1,500 euro bonus to the unemployed and those earning minimum incomes who accept moving more than 150-200 kilometers from home to find jobs.
- a tax cut on rent revenues to landlords who move out to accept a job far from home. The two measures will be introduced in the 2006 budget.

¶9. De Villepin warned the government would toughen up its welfare system, crack down on abuse, and penalize those who refuse offers of jobs or training.

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Increasing Investment in Public Transportation and Social Housing
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¶10. De Villepin announced a 10 billion euro increase in public spending on rail and road projects in 2006, to be partially funded by privatization receipts and speeding fines. The government estimated that these projects would attract an additional 5 billion euro in private spending. The government will also release state-owned land to build 20,000 new homes in the Paris region to alleviate France's housing crisis. Some homes on land that had been set aside for Paris's failed bid to host the 2012 Olympics games to the city may be used, if municipal authorities agree, to build 3,000 temporary and student housing units within 18 months. De Villepin encouraged the use of revolving mortgage loans, and announced the extension of zero-interest rate loans ("pret a taux zero") to more private real estate investors.

Respecting the EU Budget Limit of 3% of GDP

¶9. De Villepin vowed to respect the EU stability and growth pact budget limit of 3% of GDP, which the government GOF has ignored since 2002, saying the government will continue its effort to cut spending to reduce the budget deficit to below 3.0% in 2006. He said that the government would obtain 4 billion euros from the sale of government stakes in three toll highways (Autouroutes du Sud de la France, Autoroutes Paris-Rhin-Rhone and Societe des Autoroutes du Nord et de l'Est de la France) to fund new spending and cut public debt. On September 5, the government notified the European Commission it would have a 2005 budget deficit of 3% of GDP. In a press release, the Finance Minister indicated that "the forecast of 3% of GDP is based on 1.5-2.0% GDP growth." GDP growth of 2% may allow "the government to reduce the budget deficit to below 3% of GDP." Budget issues will be analyzed septel.

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Businesses Clamor for Lower Labor Costs and More
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¶10. Laurence Parisot, the new President of the French employers association ("Mouvement des Entreprises de France" - MEDEF) welcomed the Government plans, but said she hoped "a next step would be lowering labor costs," a huge impediment to job creation as payroll taxes paid by employers remained high in France. In a recent radio interview, she asserted it is her objective to reduce the

unemployment rate to 5% in five years. She indicated her willingness to participate actively in the next unemployment insurance negotiations organized by the Unemployment Insurance Agency. She suggested the minimum income ("Salaire Minimum Interprofessionnel de Croissance - SMIC") should be set "independently from political action," saying that last increases in SMIC were above what small and medium-sized companies could afford. She also invited the government to be more ambitious on the wealth tax reform.

PM's Additional Comments on Future Reforms

¶11. On September 3, in a summer meeting of the ruling party UMP in the Atlantic costal resort La Baule, De Villepin said "for 2005, we want economic growth to get as close as possible to 2%, and I think all our efforts could help us reach that. I hope growth will exceed 2% in 2006." Interestingly, he said he would announce, in coming weeks, reforms to modernize the state and cut costs to boost growth "offering a true vision of the future."

Comments

¶12. The measures announced by De Villepin on September 1 target the poor and the middle class. They may also encourage a portion of the unemployed to seek work. However, the De Villepin's plan does not address the supply-side. Hiring is heavily dependent on labor costs (including payroll taxes), labor flexibility, qualification requirements in some sectors, and labor regulations.

¶13. In the short term, but not certainly before 2006, economic growth may benefit from an increase in consumption through a decrease in unemployment, an increase in private and public investment, and additional related spending. Income tax cuts, which are a long-standing promise to voters, might help restore some consumer confidence, but they will not have any tangible economic effect before 2007, when they become effective. END COMMENTS.
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